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Public Utility Commission of Texas

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December 6, 1993

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Office of the Secretary
Federal Communications Commission
Washington, D.C. 20554

RE: In the Matter of Amendment of Parts 32 and 64 of the Commission's Rules to Account for Transactions between Carriers and Their Nonregulated Affiliates

Dear Secretary:

Enclosed for filing are an original and nine copies of the Public Utility Commission of Texas' comments in response to CC Docket 93-251.

Thank you for your assistance.

Sincerely,

Rowland L. Curry

Rowland L. Curry, P.E.
Director
Telephone Utility Analysis Division

Enclosures

cc: William A. Kehoe III

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

FCC 93-453

In the Matter of:

Amendment of Parts 32 and 64 of the Commission's Rules to Account for Transactions between Carriers and Their Nonregulated Affiliates) CC Docket No. 93-251

COMMENTS OF THE
PUBLIC UTILITY COMMISSION OF TEXAS

I. INTRODUCTION

1. On October 20, 1993, the Federal Communications Commission ("FCC" or "Commission") released its Notice of Proposed Rulemaking ("NPRM") in this proceeding.[1]

2. The FCC has asked for comments by December 10, 1993 and reply comments by January 10, 1994 in this proceeding to reevaluate the affiliate transactions rules.

3. The following comments represent the views of the Public Utility Commission of Texas ("PUC").

1 Notice of Proposed Rulemaking, CC Docket No. 93-251, released October 20, 1993.

II. VALUATION METHODS

A. Overview

4. We agree with the Commission's goal of adopting affiliate transaction rules that develop a workable system of compensating for the faulty incentives that traditional rate of return regulation gives carriers in relation to affiliate transactions. We agree that because those transactions occur at less than arm's length, carriers that are able to pass increases in their costs on to ratepayers may be motivated to pay excessive amounts for assets and services obtained from their nonregulated affiliates and that carriers also have incentives to undercharge nonregulated affiliates when the undercharges can be offset by increased charges to ratepayers.[2] However, as described below, we have concerns that the tariffed rate valuation method contains a loophole enabling a carrier to circumvent the FCC's objective of adopting affiliate transaction rules that compensate for the lack of an arm's length transaction by which to measure affiliate transactions.

B. Tariffed Rates

5. We support the proposal to retain the requirement that affiliate transactions provided pursuant to tariff be recorded at tariffed rates.[3] We also support, with one modification, the proposal to treat affiliate transactions as being provided pursuant to tariff only if the tariff is generally available, on file with a federal or state agency, and in effect. We support, with the one modification, the proposal to require all affiliate transactions meeting these three conditions to be

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2 NPRM, para. 8.

3 NPRM, para. 13.

recorded at tariffed rates.[4]

6. We propose that §32.27(b) be changed as follows: "Affiliate transactions provided pursuant to tariffs that are generally available at a specific dollars-and-cents rate, on file with a federal or state agency, and in effect shall be recorded at tariffed rates." This language would specifically exclude a tariff with an Individual Case Basis ("ICB") notation.

7. If the Commission chooses not to adopt our proposed language change to §32.27(b), we request that the record in this docket reflect that the Commission intends for the language in §32.27(b) to exclude a tariff with an ICB notation.

8. As stated earlier, we agree with the Commission's objective of adopting affiliate transaction rules that compensate for the lack of an arm's length transaction by which to measure affiliate transactions. We believe that this objective will not be achieved if the language in §32.27(b) includes a tariff with an ICB notation. Because rates set on an individual case basis are unique for each customer and may not be the result of arm's length negotiations, a carrier's use of an ICB to establish the measurement of an affiliate transaction would not compensate for the lack of an arm's length transaction by which to measure affiliate transactions.

9. In the Texas intrastate jurisdiction, Southwestern Bell Telephone Company ("SWBT") offers in its tariff services that have an ICB notation. SWBT states that ICB "denotes a condition in which the regulations, if applicable, rates and charges for an offering under the provisions of this tariff are developed based

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4 NPRM, para. 14.

on the circumstances in each case."[5] We believe that an ICB rate should be specifically excluded from the meaning of tariffed rate as it is used in §32.27(b) because the "rates and charges for an offering under the provisions of this tariff are developed based on the circumstances in each case."[6] Because the ICB rates and charges are based on the circumstances in each case, in the cases where SWBT is dealing with its affiliates, no arm's length transaction exists and the FCC's objectives are not met. To allow an affiliate to meet the Commission's requirements with an ICB is a loophole that potentially negates the Commission's entire intent in this NPRM.

10. Further, we do not believe that a tariff with an ICB notation is "generally available" because each rate is developed based on the circumstances in each case and the likelihood of each case being similarly situated is remote. Therefore, the tariffed rate test should not be available for a tariff with an ICB notation. In the alternative, the higher of cost or fair market value test should be used when a carrier is the seller. Also, a carrier may provide to its affiliate a specialized service that no other party could or would be able to use. In this case, the tariff with an ICB notation could not be considered "generally available" because only the affiliate would order the service. In the rare event that two cases are similarly situated and this fact could be used to argue that the ICB rate is generally available, the LEC is not harmed by eliminating the tariffed rate test for an ICB because the ICB rates established in one case could be used to help establish fair market value under the fair market value/fully distributed cost test described below for the next similarly situated case.

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5 **Southwestern Bell Telephone Company, Texas Division, Access Service Tariff, Section: 2, Sheet: 67**

6 Id.

C. Prevailing Company Prices

11. We agree that carrier affiliates appear to fall into two classes: those having a primary purpose to serve the carrier and other affiliates, and those that do not.[7] We also agree that dealings between the carrier and nonregulated affiliates whose purpose is to serve non-affiliates may possess many of the characteristics of arm's length transactions.[8] Further, we agree that a "bright line" test for identifying when a nonregulated affiliate's predominant purpose is to serve non-affiliates is appropriate.[9] We concur with the FCC's tentative conclusion that any nonregulated affiliate that sells less than 75 percent of its output to non-affiliates has too large a volume of affiliate transactions to be deemed to have a predominant purpose of serving non-affiliates. Lastly, we believe that if the Commission finds no workable test for determining when prevailing company prices provide reliable measures of how affiliate transactions should be valued that prevailing company pricing as a valuation method for all affiliate transactions should be abandoned.[10]

D. Fair Market Value

12. We agree with the Commission's tentative conclusion that the departures from cost-based accounting embodied in the present valuation methods for asset transfers are reasonable to the extent they mandate that transactions be recorded at estimated fair market value. We also concur with the conclusion that the FCC should continue to require all non-tariffed affiliate asset transfers for which prevailing company pricing is not permitted be recorded at the higher of net

7 NPRM, para. 19.
8 NPRM, para. 20.
9 NPRM, para. 21.
10 NPRM, para. 22.

book cost or estimated fair market value when a carrier is the seller, and at the lower of net book cost or estimated fair market value when a carrier is the purchaser.[11] Further, we believe that if the FCC completely abandons prevailing company prices as a valuation method, that all non-tariffed asset transfers between carriers and their nonregulated affiliates should be recorded at the higher of net book cost or estimated fair market value when a carrier is the seller, and at the lower of net book cost or estimated fair market value when a carrier is the purchaser.[12]

13. We support the Commission's tentative conclusion that carriers should be required to record all transactions involving the provision of services, other than those provided pursuant to tariff or permitted to be recorded at prevailing company prices, at the higher of fully distributed costs or estimated fair market value when a carrier is the seller, and at the lower of fully distributed costs or estimated fair market value when a carrier is the purchaser.[13]

III. IMPLEMENTATION

A. Costs to the Affiliate Group

14. We believe that because the FCC is proposing identical valuation methods for all types of affiliate transactions, that separate costing methods for assets and services are no longer necessary.[14]

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11 NPRM, para. 28.
12 NPRM, para. 29.
13 NPRM, para. 34.
14 NPRM, para. 45.

15. We support the Commission's proposal to require that all accounting related to affiliate transactions comply with generally accepted accounting principles (GAAP) except as otherwise ordered by the Commission.[15] We believe that this would provide consistent accounting methodologies necessary to evaluate affiliate transactions.

16. We concur with the FCC's proposal to require carriers to calculate the costs of those affiliate transactions that must be recorded at cost in accordance with traditional rate base and expense methodologies.[16]

B. Prevailing Company Prices

17. We agree with the FCC's second alternative for measuring whether an affiliate sells at least 75 percent of its output to non-affiliates. This alternative would require carriers to measure output using the nonregulated affiliate's revenues from the immediately preceding year.[17]

C. Miscellaneous Requirements

18. We support the FCC's first new cost manual requirement that nonregulated operations within carriers that do not use resources jointly or in common with regulated operations be identified in the carriers' cost manuals.[18] We agree with the second proposal to require carriers to state in their cost manuals which of their affiliates meet the 75 percent "bright line" test.[19] Thirdly, if

15 NPRM, para. 51.
16 NPRM, para. 57.
17 NPRM, para. 85.
18 NPRM, para. 94.
19 NPRM, para. 95.

alternatives to the proposal to require carriers to use the prescribed interstate rates of return in determining the return component of affiliate transactions costs are adopted, we support the proposal to require that each cost manual state the rate of return the subject carrier will use to calculate affiliate transactions costs.[20] We concur with the Commission's fourth new cost manual requirement that the cost manuals describe the carriers' proposed procedures to estimate the fair market value of all non-tariffed affiliate transactions for which the FCC does not permit prevailing company pricing.[21]

19. We support the proposal to amend Section 64.904(a) of the Commission's rules to make clear that the scope of the independent audit must encompass compliance with any requirements that the FCC adopts in this proceeding.[22] We also support the incorporation of an audit trail requirement into the rules.[23]

IV. CONCLUSION

20. In these comments, we have presented our support of the Commission's goal of adopting affiliate transaction rules that compensate for the lack of arm's length dealings between the carrier and its affiliates. We believe that our proposed modification is critical to the success of this goal. To allow a carrier to use an ICB notation in the tariff to meet the tariffed rate requirement would be like stopping only two of three foxes from guarding the henhouse. Using an ICB notation (a

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20 NPRM, para. 96.
21 NPRM, para. 97.
22 NPRM, para. 98.
23 NPRM, para. 99.

notation that results in a rate based on the circumstances in each case and not negotiated at arm's length when between the carrier and an affiliate) would be using a non-arm's length transaction to compensate for the lack of an arm's length transaction by which to measure affiliate transactions. Therefore, in order to achieve the FCC's goal, a dollars-and-cents rate offered to all customers is the only appropriate rate to use to compensate for the lack of an arm's length transaction by which to measure affiliate transactions.

Respectfully submitted,

Robert W. Gee
Chairman

Karl R. Rábago
Commissioner

Sarah Goodfriend
Commissioner

December 1, 1993

PUBLIC UTILITY COMMISSION OF TEXAS
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